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STATE FOR EEB/ESC/HENGEL, EEB/ESC/PSECOR/JKOPP, EAP/CM/HABJAN/FLATT

TREASURY FOR OASIA/ISA

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TAGS: ENRG EPET ECON SENV CH
SUBJECT: China/Oil Reserves: Active Purchases, But Facilities
Filling Up

Ref: 08 Beijing 4603

¶1. (SBU) Summary. Beijing is taking advantage of lower oil prices to build up its strategic petroleum reserves (SPR). The four existing SPR facilities - which hold the equivalent of about 25 days of imports - reportedly are now full, challenging China's ability to continue purchasing oil for reserves. Industry associations have submitted proposals to the government offering short-term reserves storage, including in private oil company tanks and offshore facilities. But these proposals, which appear to be aimed at garnering financial support for industries affected by the economic crisis, have not gained traction among policymakers. By 2011, China plans to construct enough new facilities to nearly triple its SPR capacity to the equivalent of 70 days of imports. Officials have indicated that China plans to eventually meet OECD-level SPR standards, bringing China up to the 90-day requirement for International Energy Agency (IEA) participation. End Summary.

SPR building Phase I complete, moving to Phase II
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¶2. (SBU) According to National Energy Administrator Zhang Guobao, China aims to take advantage of lower oil prices amid the global economic crisis to build its strategic petroleum reserves (SPR). China's first phase of SPR facilities, for which construction began in 2004, are located at four sites along China's coast in Zhenhai, Aoshan, Dalian, and Huangdao. According to press reports, these sites are now operating at full capacity and China plans to build an additional eight SPR bases by 2011 under Phase II of the government's SPR development program. Once completed, this will increase total SPR capacity from approximately 103 million barrels (equivalent to about 13 days of consumption or 25 days of imports) to 281 million barrels (35 days/70 days).

¶3. (SBU) Chinese media reports claim that most of the new SPR facilities will be built along the coast, although inland sites, including Lanzhou, Wanzhou, Shanshan, and Linyuan are also being considered. According to Anbang News, China National Petroleum Corporation (CNPC) has already "quietly" begun construction of SPR and commercial reserves tanks in the Tianjin Binhai New Area. The National Energy Administration (NEA) declined to discuss SPR construction plans with Econoffs.

China's oil reserves - a multi-tiered system

¶4. (SBU) National Development and Reform Commission-affiliated

Energy Research Institute (ERI) Center for Energy Economics and Development Strategy Assistant Director General Gao Shixian, told Econoff April 17 that China's crude reserves system is best understood as a multi-tiered mechanism composed of central government-funded "national" SPR bases, national oil companies (NOCs') reserves facilities, and commercial reserves facilities owned and operated by private oil companies, which primarily run smaller-scale refining operations and store refined oil products destined for gas stations.

¶5. (SBU) China's national SPR facilities are built and operated by Chinese NOCs, although the government retains decision making authority on SPR management. According to Cambridge Energy Research Associates (CERA) China Energy Director K.F. Yan, during Phase I, Sinopec held responsibility for construction of the Zhenhai and Huangdao facilities, while CNPC built those at Dalian, and Sinochem constructed facilities at Aoshan. In a conversation with Econoff on April 20, Yan said he expects Phase II construction to proceed quickly, with some facilities to be completed as early as the end of this year, but acknowledged that it is difficult to track progress, as few details have been released by the government.

¶6. (SBU) Both Yan and Gao noted that Chinese NOCs (PetroChina, Sinopec, and China National Offshore Oil Corporation) are required to maintain a government-set level of reserves at all times through a "mandatory corporate petroleum reserves" system established in ¶2007. Although mandatory corporate petroleum reserves are not considered SPR, Chinese NOCs would be obligated to supply oil from these reserves to the central government in a crisis situation. According to CERA's Yan, these reserves are managed by the NOCs, which have the authority to designate volumes and timing of releases of stock with government approval.

Private companies offer to lease facilities for SPR use
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¶7. (SBU) Low global energy prices put China in a good position to build SPR, however, given that China has already exhausted its current SPR capacity, its ability to continue to purchase oil at low prices will be limited until new SPR facilities come online. In early March, Zhao Youshan, head of the Petroleum Distribution Committee of the China General Chamber of Commerce, an industry group, reportedly submitted a proposal to government agencies recommending the use of facilities controlled by private oil companies to store SPR. Zhou stated in his proposal that China's more than 600 private oil companies have 230 million tons of storage capacity, well beyond the combined capacity of the eight proposed new SPR bases. Last year's combination of high international oil prices and low, government-set retail fuel prices reportedly left many private oil companies broke and survivors are now struggling with the high maintenance cost of empty tanks.

¶8. (SBU) According to Guan Qingyou of Tsinghua University, using idle private tanks to store SPR could help China build its SPR at a low cost while helping private refineries pull through the recession. Most analysts remain skeptical, however, and it does not appear that this proposal is gaining traction among policymakers. ERI's Gao told Econoff that private oil companies are now facing a situation in which they can earn greater profits by leasing their fuel storage tanks to the government or the NOCs, but their facilities are designed for holding refined fuel products and they are spread throughout the country, which makes them less practical as SPR facilities. CERA's Yan agreed, noting that most private companies own smaller tanks, which are less efficient and cost-effective than the large-scale tanks at existing SPR facilities.

China Shipping Group floats other SPR storage ideas
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¶9. (SBU) Li Shaode, China Shipping Group President, told the media in early March that he had proposed the government use some of its foreign exchange reserves to purchase "floating SPR storage facilities" because the onshore tanks were full. Li's proposal gained a lot of attention in the Chinese press, which highlighted that the plan would eliminate the need for additional land use while

stimulating iron, steel, ship building and other industries that have been hard hit by the global economic crisis. ERI's Gao dismissed the idea, however, explaining that China, like other countries, would be unlikely to store its SPR offshore. Yan agreed that he could "not envision the Chinese government using retired tankers to store SPR for both security and practical reasons."

China to reach IEA reserves requirement level?

¶10. (SBU) An April 14 Bloomberg report citing a CNPC newsletter stated that, according to NEA Chairman Zhang Guobao, "(China's) ultimate reserve target is to meet the level of countries in the Organization for Economic Cooperation and Development (OECD)." Reaching this goal would be tantamount to meeting the 90 days of oil imports reserves requirements for membership in the International Energy Agency (IEA). (Note: China currently participates in many IEA activities, but it has not expressed an interest in pursuing membership at this time. End Note). ERI's Gao said he was not aware of Zhang's statement, but offered that this target would not likely be reached until at least 2015 or 2020. Japanese Ministry of Foreign Affairs Economic Security Division Director Tamaki Tsukada told Econoff on April 16 following consultations in Beijing that a Chinese analyst informed him that China already has 50 to 60 days of reserves if both national SPR and NOCs' mandatory reserves are both taken into account.

Comment: SPR remains a sensitive issue

¶11. (SBU) The Chinese government continues to view SPR as a highly sensitive security issue. Chinese policy makers, in particular NEA Chairman Zhang Guobao, remain deeply suspicious of international markets and continue to blame speculators for last year's spike in international commodities prices. That said, recent domestic media coverage of China's plans to implement Phase II of its SPR development plan and Zhang Guobao's decision to state publically

China's intentions to build SPR while prices are low indicates that some efforts may be underway to increase transparency on this issue, at least at a very basic level.

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